

OPEN MEETING ITEM

ORIGINAL

COMMISSIONERS
MIKE GLEASON - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE



ARIZONA CORPORATION COMMISSION



0000091433

BRIAN C. McNEIL
Executive Director

DATE: DECEMBER 2, 2008
DOCKET NOS: W-01537A-07-0264 and W-01537A-07-0265
TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

SHEPARD WATER COMPANY, INC.
(RATE/FINANCE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

DECEMBER 11, 2008

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

DECEMBER 16, 2008 and DECEMBER 17, 2008

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

Arizona Corporation Commission

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ARIZONA CORPORATION COMMISSION
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MIKE GLEASON - Chairman
4 WILLIAM A. MUNDELL
5 JEFF HATCH-MILLER
6 KRISTIN K. MAYES
7 GARY PIERCE

8 IN THE MATTER OF THE APPLICATION OF
9 SHEPARD WATER COMPANY, INC. FOR
10 APPROVAL OF A PERMANENT RATE
11 INCREASE.

DOCKET NO. W-01537A-07-0264

12 IN THE MATTER OF THE APPLICATION OF
13 SHEPARD WATER COMPANY, INC. FOR
14 APPROVAL OF A FINANCING APPLICATION.

DOCKET NO. W-01537A-07-0265

15 DECISION NO. _____

16 **OPINION AND ORDER**

17 DATE OF HEARING: May 28, 2008

18 PLACE OF HEARING: Phoenix, Arizona

19 ADMINISTRATIVE LAW JUDGE: Marc E. Stern¹

20 APPEARANCES: Mr. Wade Noble and Mr. Jason Y. Moyes, NOBLE
21 LAW OFFICES, on behalf of Applicant; and

22 Mr. Kevin Torrey, Staff Attorney, Legal Division, on
23 behalf of the Utilities Division of the Arizona
24 Corporation Commission.

25 **BY THE COMMISSION:**

26 * * * * *

27 Having considered the entire record herein and being fully advised in the premises, the
28 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. The Commission granted a Certificate of Convenience and Necessity ("CC&N") to
Arthur E. Shepard dba Arthur E. Shepard Water Company in Decision No. 30467 (August 19, 1957).
In Decision No. 49481 (November 28, 1978) the Commission authorized the sale of assets and

¹ Administrative Law Judge Marc E. Stern presided over the hearing and Administrative Law Judge Jane Rodda wrote the Recommended Opinion and Order.

1 transfer of CC&N to James L. and Francine S. Tomlinson dba Shepard Water Company. In Decision
2 No. 52989 (April 29, 1982), the Commission authorized the transfer of the CC&N and assets to
3 Shepard Water Company, Inc., a corporation ("Shepard" or "Company").

4 2. The current owners, John and Gail Guth, purchased the Company in 2001 and are the
5 sole stockholders.

6 3. Mr. and Mrs. Guth also own Martinez Lake Sewer Company, Martinez Lake Resort,
7 Martinez Lake Marina and Martinez Lake Cantina.

8 4. Shepard serves the resort community at Martinez Lake which is located approximately
9 30 miles northeast of Yuma, along the Colorado River.

10 5. In Decision No. 62091 (November 19, 1999) the Commission authorized Shepard to
11 borrow \$299,475 from the Arizona Water Infrastructure Finance Authority ("WIFA") to fund
12 upgrades to the Company's water system and install meters for its residential customers. In that
13 Decision, the Commission authorized a \$5.00 surcharge in Phase I and a \$10.00 surcharge in Phase II
14 for the debt service on the loan. The Phase II surcharge was to be implemented after the Company
15 filed a report showing satisfactory progress toward completing the first phase of construction.²

16 6. On August 7, 2006, the Company filed a Progress Report of the status of the Phase I
17 improvements, and requested authorization to implement the \$10 Phase II surcharge. When the
18 Commission's Utilities Division ("Staff") reviewed the Company's request, Staff discovered that the
19 Company only received one disbursement from that loan in the amount of \$3,900 in April 2002.

20 7. The Company began making monthly payments on the loan to WIFA in August 2002,
21 and began collecting the Phase I \$5.00 surcharge in October 2005.

22 8. On September 29, 2006, Staff filed a report that stated that the Company was not in
23 compliance with several Commission requirements. "These included failure, among other things, to
24 notify the Commission when implementing its Phase I surcharge, failure to comply with Arizona
25 Department of Environmental Quality ("ADEQ") requirements as ordered in the decision, failure to
26 install customer meters, and failure to provide timely support for any Water Infrastructure Finance

27 ² See Decision No. 62091 at p 14. It was anticipated that the Phase I surcharge would terminate when the Commission's
28 Utilities Division Staff had reviewed the progress report to be filed by the Company, and had deemed it acceptable, and
would be replaced by the \$10 Phase II surcharge.

1 Authority loan activity.” Staff recommended denial of the Company’s request to implement the \$10
2 Phase II surcharge; that the Company provide an accounting of all Phase I collections; and that it file
3 a rate application no later than December 31, 2006 using a September 30, 2006, test year in order to
4 address its arsenic problem.

5 9. By Procedural Order issued on October 25, 2006,³ Staff’s recommendations were
6 adopted. On February 23, 2007, the Company filed a Motion requesting to extend the time to make
7 the filings until May 1, 2007. By Procedural Order dated April 3, 2007, the Company’s request for
8 extension was granted.

9 10. On May 1, 2007, Shepard filed with the Commission an application for the approval
10 of a permanent rate increase and an application for approval of financing to fund the cost of arsenic
11 remediation equipment. Shepard requested authority to borrow \$112,100 from WIFA and a \$5.00 per
12 month surcharge to service the debt related to the loan.

13 11. On May 31, 2007, pursuant to A.A.C. R14-2-103, Staff issued a notice of
14 insufficiency with respect to the Company’s rate application.

15 12. On June 28, 2007, Staff issued a second notice of insufficiency to the Company.

16 13. On July 27, 2007, pursuant to A.A.C. R14-2-103, Staff notified the Company that its
17 rate application was sufficient pursuant to the Arizona Administrative Code, and classified the
18 Company as a Class D water utility.

19 14. On August 15, 2007, Staff filed a Motion to Consolidate the above-captioned rate and
20 financing applications because they are interrelated and approval of the financing application cannot
21 be determined without approval of the pending rate case.

22 15. On August 21, 2007, Staff filed a Motion for Extension on behalf of Shepard because
23 the Company had indicated that it needed additional time to file responses to Staff’s data requests.
24 Further, after reviewing the Applications, Staff asserted that additional time was needed for more
25 discovery prior to the issuance of a Staff Report and that it appeared the time clock for a final order
26 would need to be suspended.

27
28 ³ In Docket Nos. W-01537A-99-0100 and W-01537A-99-0296.

1 16. On August 24, 2007, the Company filed a Response and agreed with Staff's Motion.

2 17. On August 28, 2007, by Procedural Order, the above-captioned rate and financing
3 applications were consolidated, and the time clock for a final Commission order was suspended.

4 18. On July 5, 2007, and on March 14, 2008, the Company mailed, by first class U.S.
5 mail, public notice to its customers of its rate and financing applications, respectively. The
6 Commission did not receive any responses as a result of the Company's notices.

7 19. On March 18, 2008, Staff filed its Staff Report with respect to the Company's
8 Applications, and recommended approval of its rates and charges and further recommended the
9 authorization of an arsenic remediation surcharge mechanism ("ARSM") to enable the Company to
10 recover the costs of arsenic remediation equipment.

11 20. On March 28, 2008, the Company filed "Comments on Staff Report Dated March 18,
12 2007." Therein, the Company attempted to explain the circumstances surrounding use of the prior
13 WIFA loan, provided an update of the installation of customer meters and the arsenic remediation
14 equipment and sought clarification as to why Staff had deemed the Company's progress insufficient
15 to allow implementation of the \$10 Phase II surcharge.

16 21. By Procedural Order dated April 3, 2008, the consolidated matter was set for hearing
17 on May 28, 2008.

18 22. On April 15, 2008, Shepard mailed notice of the hearing to all customers by first class
19 U.S. mail.

20 23. A full public hearing was held as scheduled on May 28, 2008, before an
21 Administrative Law Judge pending submission of a Recommended Opinion and Order to the
22 Commission.

23 24. In March 2007, the Company began constructing a new well and installation of a
24 55,000 gallon storage tank, booster system, waterlines and fire hydrants. The new well was not
25 productive and abandoned. ADEQ issued its Certificate for Approval to Construct ("ATC") for the
26 storage tank and booster system, as well as the arsenic treatment system on November 13, 2006, and
27 Yuma County issued its ATC for the distribution system on September 14, 2006.

28 25. During the test year ended December 31, 2006, Shepard provided water service to an

1 average of 224 customers, comprised of 221 flat rate residential customers, and 3 metered
2 commercial customers. However, during the hearing, Mr. Guth testified that the Company was
3 currently providing service to only about 100 residential customers and the three metered commercial
4 customers.⁴ Mr. Guth is upgrading the entire resort, eliminating trailers and motor coaches in favor
5 of permanent masonry houses.⁵ According to the Company, at the time the first WIFA loan was
6 awarded, Martinez Lake Resort was planning a residential subdivision, which would include road and
7 street replacement and other improvements, including the construction of a sewer system by Martinez
8 Lake sewer Company (also owned by the Guths). The Company states that because trenching would
9 be required for the sewer and other utilities, trenching for the water system upgrades was postponed
10 in order to be completed at the same time as the other utilities. The Company explains that this is
11 why the \$3,900 disbursement for the well was the only portion of the loan that has funded to date.⁶

12 26. Previously, the U. S. Environmental Protection Agency ("EPA") announced that the
13 arsenic standard in drinking water would be reduced from 50 parts per billion ("ppb") to 10 ppb by
14 2006. The Company was not in compliance with the new arsenic maximum contaminant level, with
15 an arsenic maximum contaminant level ("MCL") of 12 ppb.⁷ The Company plans to use the monies
16 from its current financing request to fund the installation of plant to address its arsenic levels. At the
17 time of the hearing, the Company had already installed the arsenic treatment facility and was
18 providing water that meets the EPA standards, with an arsenic MCL of 2 to 3 ppb.⁸

19 27. In a Compliance Status Report dated April 30, 2007, ADEQ also reported major
20 deficiencies because the Company failed to provide consumer confidence reports for 2002 and 2003.

21 28. In the test year ended December 31, 2006, as adjusted by Staff, Shepard had total
22 operating revenue of \$49,918, and an operating income of \$5,098, or a 10.21 percent operating
23 margin. With an adjusted original cost rate base ("OCRB") of \$11,772, the Company had a rate of
24 return on its adjusted OCRB of 43.49 percent.

25
26 ⁴ Transcript of May 28, 2008 Hearing ("Tr") at 36.

27 ⁵ Tr. at 33.

28 ⁶ Comments on Staff Report filed March 28, 2008.

⁷ Tr at 28.

⁸ *Id.*

1 29. The Company proposed an additional \$5.00 per month customer arsenic surcharge,
2 and no change to its existing \$16.50 monthly flat rate charge. The Company originally proposed
3 implementing the \$10.00 Phase II surcharge discussed in Decision No. 62091, but appears to have
4 accepted Staff's recommendation to only retain the Phase I \$5.00 per month system replacement
5 surcharge approved in Decision No. 62091. The Company's proposed arsenic surcharge would
6 increase the typical residential flat rate bill from \$21.50⁹ to \$26.50 for an increase of \$5.00, or 23.3
7 percent.

8 30. The Company's proposed surcharge and other rates, as filed, would produce total
9 operating revenue of \$76,100¹⁰ and operating income of \$21,931, or a 28.82 percent operating
10 margin. Based on the Company's claimed OCRB of \$39,412, its requested revenue would have
11 resulted in a rate of return of 55.65 percent on its OCRB.

12 31. The Company has requested authorization to issue long-term debt to WIFA in an
13 amount not to exceed \$112,100 and has requested a rate increase in the form of a \$5.00 monthly
14 surcharge to pay for debt service.

15 32. Staff also recommends approval of the financing and for an ARSM to be implemented
16 after the Company has met certain conditions. Staff states that implementation of its recommended
17 ARSM would enable the Company to meet its principal and interest obligations on the actual amount
18 of the WIFA loan and to pay income taxes on the surcharges.

19 33. Staff recommends total operating revenue of \$60,699 (including the arsenic
20 surcharge), and operating income of \$15,879, which would result in a return on adjusted OCRB of
21 135.45 percent and an operating margin of 26.16 percent.

22 34. Staff's adjustments decreased the Company's proposed rate base by \$27,690, from
23 \$39,412 to \$11,722. Staff adjusted plant accounts to reflect all plant additions and retirements from
24 the end of the test year in the last rate case, to capitalize labor costs, and to remove plant that was no
25 longer in operation. Staff increased accumulated depreciation based on its adjustments to plant in
26

27 ⁹ \$16.50 plus \$5.00.

28 ¹⁰ As filed, the Company's requested revenue included \$26,880 from the Phase II surcharge that was conditionally
established in Decision No. 62091.

1 service. Staff further determined a cash working capital balance of \$4,761, based on the formula
2 method. The Company did not dispute any of Staff's calculations and they appear reasonable.

3 35. We adopt Staff's recommended OCRB of \$11,722, which is the same as its Fair Value
4 Rate Base ("FVRB").

5 36. Staff's adjustments decreased test year operating revenue by \$12,541, from \$62,459 to
6 \$49,918. Staff increased metered water revenue by \$219, from \$5,347 to \$5,566, to reflect Staff's
7 calculation of revenue for the 1 inch customer using the Company provided billing determinants;
8 increased unmetered water revenue by \$660, from \$43,692 to \$44,352, to reflect the number of
9 customers each month times the flat rate; and decreased other water revenue by \$13,420, from
10 \$13,420 to \$0 to remove the Phase I surcharge revenue because the related expenses (i.e. depreciation
11 expense on the plant and interest expense on the long-term debt) are not included in Staff's
12 calculation of the amount of the rate increase needed.

13 37. Staff's adjustments to operating expenses resulted in a net decrease of \$9,348, from
14 \$54,169 to \$44,821. Staff's major adjustments included decreasing materials and supplies by \$1,048,
15 to remove capitalized labor costs associated with installing a pump; increasing outside services by
16 \$6,664, as the Company has no employees and utilizes outside services to operate and manage the
17 Company; decreasing miscellaneous expense by \$9,432 to reclassify legal and accounting services to
18 outside services; and decreasing income tax expense by \$5,544 to reflect the calculation of income
19 tax expense based on Staff's adjusted test year taxable income.

20 38. Although the Company only borrowed \$3,900 of the previously approved \$299,475
21 WIFA loan, the Company states that WIFA required it to make monthly payments of \$2,662.80 in
22 order to retain the entire loan. Mr. Guth provided the funds, totaling \$140,919 (\$117,398 principal
23 and \$23,521 interest), for the Company to make these monthly payments to WIFA over
24 approximately 4 ½ years.

25 39. The Company recorded Mr. Guth's principal payments in an account entitled
26 "Notes/Accounts Payable to Associated Companies." Staff reported that as of December 31, 2006,
27 the balance in this account was \$118,956, which included the \$117,398 in principal payments plus
28 \$1,558 of additional costs incurred on behalf of Shepard.

1 40. Staff believes that the payments made by Mr. Guth represent a long-term loan that was
2 not Commission approved, and for ratemaking purposes, Staff did not recognize the amount of
3 advances from Mr. Guth in the revenue requirement calculations. Staff recommends these payments
4 be treated as Additional Paid-in Capital.¹¹

5 41. The Company reported the remaining \$182,800 balance of the \$299,575 WIFA loan as
6 long-term debt. Staff states that because the Company only drew down \$3,900 of the WIFA loan and
7 has been authorized to collect a \$5 monthly customer surcharge specifically to pay the loan, Staff
8 does not reflect this loan in its calculation of the revenue requirement.

9 42. Including Staff's recommended ARSM (discussed in more detail below), Staff
10 recommends total operating revenue of \$60,699, an increase of \$10,781, or 21.60 percent above
11 Staff's adjusted test year revenue of \$49,918. The amount of Staff's recommended revenue increase
12 is attributable to the arsenic surcharge. Staff states further that its recommended revenue requirement
13 is primarily driven by the revenues needed to pay the principal, interest and to meet the minimum 1.2
14 Debt Service Coverage ratio required by WIFA for the loan. Additionally, Staff believes its revenue
15 requirement provides sufficient cash flow to pay operating expenses and contingencies.

16 43. Staff states that small water utilities often have a rate base that is too small to earn a
17 meaningful rate of return, and that the revenues needed to make these companies financially viable
18 result in abnormally high rates of return. It is Staff's view that Shepard is among those water
19 companies whose large debt service requirement and small rate base results in abnormally high rates
20 of return when compared to other, more financially capable, companies.

21 44. Shepard is in the process of metering all of its residential customers. Its three
22 commercial customers already have meters. Mr. Guth testified all residential customers could be
23 metered by year end 2008.¹²

24 45. Staff recommends that the existing \$16.50 per month flat rate charge continue until all
25 residential customers are metered and properly notified of the approved rate change. To promote
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27

28 ¹¹ Tr at 80.

¹² Tr. at 40.

efficient use of water, Staff recommends that after all customers are metered, the Company implement an inverted three-tiered rate structure.

46. The rates and charges for Shepard as proposed in the Applications, and as recommended by Staff are as follows:

	<u>Present Rates</u>	<u>Proposed Company</u>	<u>Rates Staff</u>
<u>MONTHLY USAGE CHARGE:</u>			
Unmetered Rates – Residential	\$ 16.50	\$16.50	\$16.50
5/8" x 3/4" Meter	6.75	6.75	9.75
3/4" Meter	15.13	15.13	15.13
1" Meter – Only meter currently in use	31.88	31.88	31.88
1 1/2" Meter	73.75	73.75	73.75
2" Meter	124.00	124.00	124.00
3" Meter	241.25	241.25	241.25
4" Meter	408.75	408.75	408.75
6" Meter	827.50	827.50	827.50
Gallons Included in Monthly Customer Charge:			
For all meter sizes	N/A	0	0
Uniform Commodity Rate			
Per 1,000 gallons for all usage	\$2.05	\$2.05	N/A
5/8-Inch x 3/4-Inch Meters			
0 to 3,000 gallons			\$1.25
3,001 to 10,000 gallons			1.80
10,001 and above gallons			2.30
1-Inch Meters			
0 to 40,000 gallons			\$1.80
40,001 and above gallons			2.30
Surcharges (Implemented in Accordance to Dec. 62091)			
Phase I		\$5.00	\$5.00
Phase II (Not yet implemented)		\$10.00	N/A

...

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SERVICE LINE AND METER INSTALLATION CHARGES:

	Current Charges	Company's Proposed Charges	Staff Recommended Service Line Charges	Staff Recommended Meter Charges	Staff Recommended Total Charges
5/8" x 3/4" Meter	\$ 410.00	\$ 410.00	\$ 290.00	\$ 120.00	\$ 410.00
3/4" Meter	440.00	440.00	290.00	150.00	440.00
1" Meter	470.00	470.00	310.00	160.00	470.00
1 1/2" Meter	715.00	715.00	330.00	385.00	715.00
2" Meter	1,820.00	1,820.00	395.00	1,425.00	1,820.00
3" Meter	2,410.00	2,410.00	475.00	1,935.00	2,410.00
4" Meter	3,455.00	3,455.00	710.00	2,745.00	3,455.00
6" Meter	6,650.00	6,650.00	1,070.00	5,580.00	6,650.00

SERVICE CHARGE:

Establishment	\$25.00	\$25.00	\$25.00
Establishment (After Hours)	40.00	40.00	40.00
Reconnection (Delinquent)	25.00	25.00	25.00
Reconnection (Delinquent-After hours)	N/A	N/A	N/A
Meter Test (If Correct)	40.00	40.00	40.00
Deposit	*	*	*
Deposit Interest	*	*	*
Reestablishment (Within 12 Months)	**	**	**
NSF Check	\$20.00	\$20.00	\$20.00
Deferred Payment (Per Month)	1.50%	1.50%	1.50%
Meter Reread (If Correct)	15.00	15.00	15.00
Late Payment Penalty	1.50%	1.50%	1.50%
Fire Sprinkler System	***	***	***

* Per Commission rule A.A.C. R-14-2-403(B).

** Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

*** 1.00% of Monthly Minimum for a Comparable Size Meter Connection, but no less than \$5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct for the primary water service line.

47. Staff recommends an ARSM (estimated at \$3.93) to be implemented conditional upon certain requirements. Staff further recommends no change to the Company's existing \$5.00 per month system replacement surcharge approved in Decision No. 62091. Staff's recommended pre-metered rates would increase the typical residential bill from \$21.50 to \$25.43 (\$16.50 monthly charge, plus \$5.00 Phase I system replacement charge, plus \$3.93 ARSM), an increase of \$3.93 or 18.3 percent. Staff's inverted three tiered rate design would increase the typical residential bill, with

1 an average usage of 4,796 gallons, from \$21.50 to \$25.66 (\$16.73 average bill plus \$5.00 system
2 replacement surcharge plus \$3.93 ARSM) an increase of \$4.16 or 19.35 percent.

3 48. The Company has three metered one-inch customers that are charged a uniform rate of
4 \$2.05 per thousand gallons. To promote efficient use of water, Staff recommends an inverted two-
5 tiered rate structure for commercial customers. Staff states that its recommended rate design
6 generates approximately the same level of revenue from the one inch customers as the Company's
7 current rate design.

8 49. Shepard does not object to Staff's recommended rates and charges.¹³

9 50. In addition to the recommended adoption of its rates and charges as discussed herein,
10 Staff further recommends:

11 (a) That the Company notify the Commission when all residential customers are
12 metered;

13 (b) That the Company implement the inverted three-tiered rate design after all
14 residential customers have been metered and properly noticed;

15 (c) That once all residential customers are metered, the Company notify the residential
16 customers, in a form acceptable to Staff, of when the metered rates will begin;

17 (d) That metered residential rates not begin until the month after all customers have
18 been notified of such in a form acceptable to Staff;

19 (e) That the Company file with Docket Control a tariff schedule of its new rates and
20 charges within 30 days after the effective date of the Decision in this proceeding; and

21 (f) That the Company capitalize rather than expense labor costs incurred for installing
22 plant items such as, but not limited to, pumps, by recording them in the proper plant accounts in
23 accordance with the NARUC USOA.

24 51. The purpose of the proposed financing is to provide funds for construction of arsenic
25 removal treatment plant that will enable the Company to provide water that meets the EPA arsenic
26 standards. The anticipated amortization period and interest rate will be determined by WIFA.¹⁴

27 _____
28 ¹³ Tr at 15. However, Mr. Guth continues to believe that the Phase II surcharge established in Decision No. 62091 should also be implemented. Tr at 31.

1 52. Staff states that because the details of the WIFA loan will not be known until after the
2 rate application has been decided, Staff recommends an ARSM. According to Staff, an ARSM is
3 appropriate because without treatment the Company was not providing water that meets federal
4 drinking water standards for arsenic and it does not have access to other funding sources to correct
5 the arsenic problem.

6 53. Staff states the ARSM will establish the methodology to determine the amount of the
7 surcharge based upon the final WIFA loan service requirements. Staff asserts the Company can
8 submit an arsenic removal surcharge application to the Commission under this Docket in order to
9 receive the surcharge using the methodology Staff sets out in the Staff Report once Shepard closes on
10 the loan; and the Company meters all of its customers by September 30, 2008.¹⁵

11 54. Staff states that because the Company must comply with the EPA arsenic standard
12 regardless of its financial position, Staff calculated the additional annual revenue that Shepard would
13 require to meet its obligations on the proposed \$112,100 loan (using Staff's recommended ARSM)
14 and maintaining the same cash flow it would have without the loan in place. Staff determined that
15 with a \$112,100 WIFA loan, the Company would need additional annual revenue of \$10,780 to
16 service the associated debt (including \$2,825 for principal, \$7,208 for interest expense and \$747 for
17 income taxes).

18 55. Staff's financial analysis of the proposed \$112,100 WIFA loan was based on
19 December 31, 2006, financial results. As of December 31, 2006, Shepard's capital structure
20 consisted of 100 percent equity. If the Company drew the entire \$112,100 loan, its capital structure
21 would consist of 1.3 percent short-term debt, 50.5 percent long-term debt and 48.2 percent equity.

22 56. Staff's pro forma analysis, based on December 31, 2006 information, shows that
23 drawing down the entire proposed loan and with the implementation of Staff's proposed ARSM, the
24 Company would have a Times Interest Earned Ratio ("TIER") of 2.16 and Debt Service Coverage
25

26
27 ¹⁴ WIFA typically utilizes a 20 year amortization and an interest rate determined as follows: (Prime rate + 2 percent) x
subsidy rate = (7.25% + 2%) x .70 = 6.475%.

28 ¹⁵ Staff originally recommended May 31, 2008, but revised its recommendation at the hearing. Tr at 47.

1 ratio ("DSC") of 1.74.¹⁶ Staff states that these ratios indicate that Shepard would have sufficient
 2 earnings and operating cash flow to meet the long-term debt obligations of the \$112,200 loan.

3 57. Staff concludes that the construction of the arsenic treatment system is necessary for
 4 Shepard to comply with the EPA's revised drinking water standard that requires reducing the arsenic
 5 level in drinking water to 10 ppb. Staff concludes that the arsenic treatment system project is
 6 appropriate and the cost estimate of \$112,100 is reasonable. Staff states, however, that it has not
 7 made a "used and useful" determination of the proposed project items, and that no particular
 8 treatment should be inferred for rate making or rate base purposes in the future.

9 58. Staff further concludes that the Company will need a loan of up to the total \$112,100
 10 to purchase an arsenic treatment system to comply with the EPA revised drinking water standard.

11 59. In addition to its recommended rates and charges set forth herein, Staff further
 12 recommends:

- 13 (a) Approval of the requested \$112,100 financing;
- 14 (b) The amount of the ARSM be conditional upon the actual amount of the loan which
 15 is not to exceed \$112,100;
- 16 (c) That the ARSM be implemented only after the Company closes on the loan and all
 17 customers have been metered;
- 18 (d) That the Company make an ARSM filing within 60 days of the loan closing;
- 19 (e) That if the Company has not drawn funds from the loan within one year of the date
 20 of the Decision resulting from this proceeding, that approval of the loan and surcharge be rescinded;
- 21 (f) That all customer be metered by September 30, 2008;
- 22 (g) That the Company file for a rate application by no later than May 1, 2010, using a
 23 test year ending December 31, 2009;

24 _____
 25 ¹⁶ TIER represents the number of times earnings cover interest expense on short-term and long-term debt. A TIER
 26 greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in
 27 the long term but does not mean that debt obligations cannot be met in the short term. DSC represents the number of
 28 times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A
 DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means
 that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed
 to avoid default.

1 (h) That the Company file with Docket Control, as a compliance item in this case, a
2 copy of an updated ADEQ Compliance Status Report indicating that the deficient consumer
3 confidence reports issue has been resolved;

4 (i) That any new rates and charges approved in this proceeding not become effective
5 until the first day of the month following the Company's filing of the updated ADEQ Compliance
6 Status Report indicating that the Company has resolved the noted deficiencies;

7 (j) That the Company file with Docket Control, as a compliance item in this case, by
8 December 31, 2008, a copy of the ADEQ Certificate of Approval of Construction for the arsenic
9 treatment system;

10 (k) That the Company use Staff's depreciation rates as delineated in Table B of the
11 Engineering Report attached to the May 18, 2008 Staff Report; and

12 (l) That the Company continue its existing "total" charges for service line and meter
13 installations as set forth in Table C of the Engineering Report attached to the Staff Report.

14 60. Staff reviewed the Commission's records and found no complaints, inquiries or
15 opinions filed concerning the Company for the period from January 1, 2004, through May 9, 2007.

16 61. Staff reports that Shepard is current on its Utilities and Corporations Divisions' annual
17 reports and also current with its sales and property tax payments.

18 62. The Company is not located in an Active Management Area ("AMA") and is not
19 subject to any AMA reporting and conservation requirements.

20 63. Following the hearing, on August 8, 2008, Staff received an updated ADEQ
21 Compliance Status Report indicating the Company had no major deficiencies and that it currently
22 delivers water that meets the water quality standards required by the Arizona Administrative Code,
23 Title 18, Chapter 4.

24 64. On August 12, 2008, Staff filed a Response to the Company's Late-filed Exhibit.
25 Based on the updated ADEQ Compliance Status Report, Staff believes that the Company has
26 resolved the ADEQ deficiencies. Consequently, Staff recommends that Shepard has met Staff's
27 recommended conditions in paragraph 59 (h) and (i) above, and should be granted permission to
28 charge Staff's recommended rates and charges.

1 65. Staff's recommendations are reasonable and should be adopted. We note, however,
2 that Staff's recommendations were based on test year customer counts which were significantly
3 greater than the number of customers (as reported at the hearing). As such, the rates and charges
4 proposed by Staff do not appear likely to provide the total revenue that Staff recommends unless Mr.
5 Guth is able to sell or rent additional lots. Mr. Guth appears to understand that unless the customer
6 numbers increase, he will face a cash flow deficit.¹⁷

7 66. Similarly, Staff's estimate for the expected surcharge as a result of the ARSM was
8 based on an assumption there were 224 customers, when at the hearing, it appears that circumstances
9 have changed and the Company only has approximately 100 residential customers. Using Staff's
10 methodology as set forth in the March 18, 2008 Staff Report, but the smaller customer number,
11 results in an estimated arsenic remediation surcharge of \$8.36 for the ¾ inch meter. The actual
12 surcharge will be determined by the final loan amount as well as the current number of customers and
13 is not known with certainty at this time.

14 67. We agree with Staff that the arsenic remediation equipment is necessary for the
15 Company to provide water that meets all water quality standards, and we agree with Staff's proposed
16 methodology for determining the amount of the arsenic remediation surcharge. We believe however,
17 that particularly in light of the expectation that the rates recommended and approved herein may not
18 generate as much revenue as assumed in the Staff Report, the amounts collected pursuant to the
19 arsenic surcharge should be segregated in a separate account and used only for the repayment of the
20 WIFA loan that financed the arsenic remediation facilities.

21 68. Although it appears that because of changed circumstances since Staff inspected the
22 system and prepared its Staff Report, namely a significant reduction in the number of customers, we
23 do not have sufficient information based on the record before us to determine rates that would yield
24 the same cash flow that Staff, or the Company used to formulate their recommendations. We cannot
25 make major alterations on the revenue side of the revenue requirement formula without also
26 examining the expense side of the equation. We do not have sufficient evidence at this time to
27

28 ¹⁷ Tr. at 32.

1 determine with sufficient accuracy the effect of fewer customers on operating expenses. We note that
2 all of the revenue increase recommended by Staff was to finance the arsenic treatment equipment.
3 We believe the best course of action is to approve Staff's recommended rates and charges, which will
4 at least allow the Company to finance its arsenic treatment plant, and to note that the Company
5 should seriously consider filing another rate case as soon as it can after installing the system
6 upgrades, and does not have to wait until Staff's recommended deadline for the next rate case.

7 69. The \$10.00 Phase II surcharge approved in Decision No. 62091 was for the purpose of
8 repaying the WIFA loan approved in that Decision. For some reason, the Company did not draw on
9 that loan to make the system upgrades, but Mr. Guth appears to have made many of those upgrades
10 himself. We do not know at this time the status of that WIFA loan. Mr. Guth seemed to be under
11 the impression WIFA would still advance funds under the earlier authority.¹⁸ Staff appears to
12 believe that Mr. Guth may have a claim against WIFA for the return of the monies he, or the
13 Company, paid to WIFA, and perhaps that the earlier authority should be rescinded.¹⁹ In any case,
14 Staff does not recommend implementation of the Phase II surcharge. We agree with Staff's
15 recommendation concerning the Phase II surcharge, as the surcharge was intended to repay the
16 WIFA loan, of which only \$3,900 has been drawn on.

17 70. Based on the rates and charges approved herein, and an estimated ARSM surcharge of
18 \$8.36 (based on the updated customer count), the typical residential bill would increase from \$21.50 to
19 \$29.86, an increase of \$8.36, or 38.9 percent.

20 CONCLUSIONS OF LAW

21 1. Shepard is a public service corporation pursuant to Article XV of the Arizona
22 Constitution and A.R.S. §§ 40-250 and 40-251.

23 2. The Commission has jurisdiction over Shepard and the subject matter of the
24 applications.

25 3. Notice of the proceeding was provided in conformance with law.

26 4. The rates and charges approved herein are reasonable.

27
28 ¹⁸ Tr. at 26-27. See also the Company's Comments to the Staff Report

¹⁹ Tr at 80 and 82.

5. Staff's recommendations, as modified herein, are reasonable and should be adopted.

6. The financing approved herein is for lawful purposes within Shepard's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by the Company of service as a public service corporation, and will not impair Shepard's ability to perform the service.

7. The financing approved herein is for the purposes stated herein, is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

ORDER

IT IS THEREFORE ORDERED that the rates and charges set forth below are approved and Shepard Water Company, Inc. shall file with Docket Control within 30 days of the effective date of this Decision, as a compliance item in this docket, a tariff that complies with the rates and charges approved herein:

MONTHLY USAGE CHARGE:

Unmetered Rates – Residential

5/8" x 3/4" Meter	\$16.50
3/4" Meter	9.75
1" Meter	15.13
1 1/2" Meter	31.88
2" Meter	73.75
3" Meter	124.00
4" Meter	241.25
6" Meter	408.75
	827.50

GALLONAGE CHARGE – (PER 1,000 GALLONS)

5/8-Inch x 3/4-Inch Meters

0 to 3,000 gallons	\$1.25
3,001 to 10,000 gallons	1.80
10,001 and above gallons	2.30

1-Inch Meters

0 to 40,000 gallons	\$1.80
40,001 and above gallons	2.30

Surcharges (Implemented in Accordance to Dec. 62091)

System Replacement Surcharge - Phase I	\$5.00
Arsenic Surcharge	TBD

SERVICE LINE AND METER INSTALLATION CHARGES:

	Service Line Charges	Meter Charges	Total Charges
5/8" x 3/4" Meter	\$ 290.00	\$ 120.00	\$ 410.00
3/4" Meter	290.00	150.00	440.00
1" Meter	310.00	160.00	470.00
1 1/2" Meter	330.00	385.00	715.00
2" Meter	395.00	1,425.00	1,820.00
3" Meter	475.00	1,935.00	2,410.00
4" Meter	710.00	2,745.00	3,455.00
6" Meter	1,070.00	5,580.00	6,650.00

SERVICE CHARGE:

Establishment	\$25.00
Establishment (After Hours)	40.00
Reconnection (Delinquent)	25.00
Reconnection (Delinquent - After Hours)	N/A
Meter Test (If Correct)	40.00
Deposit	*
Deposit Interest	*
Reestablishment (Within 12 Months)	**
NSF Check	20.00
Deferred Payment	1.50%
Meter Reread (If Correct)	15.00
Late Payment Penalty	1.50%
Fire Sprinkler System	***

* Per Commission rule A.A.C. R-14-2-403(B).

** Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

*** 1.00 % of Monthly Minimum for a Comparable Size Meter Connection, but no less than \$5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct for the primary water service line.

IT IS FURTHER ORDERED that the flat rate rates and charges approved herein shall be effective for all usage on and after January 1, 2009, and that the metered rates and charges approved herein shall be effective for all usage on and after the first of the month after Shepard Water Company, Inc. has metered all customers, notified the Commission that such metering is complete, and provided notice to the customers of the approved rates and charges in a form that is acceptable to

1 Commission Staff.

2 IT IS FURTHER ORDERED that Shepard Water Company, Inc. shall install meters for all
3 customers no later than January 31, 2009.

4 IT IS FURTHER ORDERED that Shepard Water Company, Inc. shall file with Docket
5 Control a notice, as a compliance item in this docket, when all customers have been metered.

6 IT IS FURTHER ORDERED that Shepard Water Company, Inc. is hereby authorized to
7 borrow up to \$112,100 from the Water Infrastructure Finance Authority for a term of 20 years and on
8 such terms and interest rates as are prevailing at the time the Water Infrastructure Finance Authority
9 approves the loan to finance the purchase and installation of arsenic treatment facilities.

10 IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon
11 Shepard Water Company, Inc.'s use of the proceeds for the purposes stated in its application and
12 approved herein.

13 IT IS FURTHER ORDERED that Shepard Water Company Inc. is authorized to execute any
14 documents necessary to effectuate the authorizations granted.

15 IT IS FURTHER ORDERED that Shepard Water Company Inc. shall file with Docket
16 Control, as a compliance item in this docket, copies of any executed financing documents related to
17 this authority within 30 days of execution.

18 IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not
19 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
20 proceeds derived thereby for purposes of establishing just and reasonable rates.

21 IT IS FURTHER ORDERED that Shepard Water Company, Inc. shall file with Docket
22 Control in this docket, an arsenic remediation surcharge application for the \$112,100 WIFA loan
23 within 60 days of the loan's closing.

24 IT IS FURTHER ORDERED that the arsenic surcharge shall be a separate line item charge on
25 customers' monthly bill labeled as "arsenic surcharge."

26 IT IS FURTHER ORDERED the arsenic surcharge shall not go into effect until after Shepard
27 Water Company, Inc. closes on the loan and all customers have been metered.

28 IT IS FURTHER ORDERED that Shepard Water Company, Inc. shall segregate the amounts

1 collected pursuant to the arsenic surcharge in a separate account and shall use such funds only for the
2 repayment of the WIFA loan approved herein for the financing of the arsenic remediation facilities

3 IT IS FURTHER ORDERED that Shepard Water Company shall file a new rate case by no
4 later than May 1, 2010, using a test year ending December 31, 2009, however, nothing herein shall
5 prevent Shepard Water Company, Inc., from filing a rate application earlier.

6 IT IS FURTHER ORDERED that if Shepard Water Company, Inc. has not drawn funds from
7 the loan approved herein within one year of the effective date this Decision, authority for the loan and
8 arsenic surcharge shall be rescinded.

9 IT IS FURTHER ORDERED that Shepard Water Company, Inc. shall file with Docket
10 Control, as a compliance item in this case, by January 31, 2009, a copy of the ADEQ Certificate of
11 Approval of Construction for the arsenic treatment system

12 IT IS FURTHER ORDERED that Shepard Water Company, Inc. shall use Staff's
13 depreciation rates delineated in Table B of the Engineering Report attached to the May 18, 2008 Staff
14 Report.

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1 IT IS FURTHER ORDERED that if Shepard Water Company, Inc. shall capitalize rather than
2 expense labor costs incurred for installing plant items such as, but not limited to, pumps by recording
3 them in the proper plant accounts in accordance with the NARUC USOA.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
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7

8 CHAIRMAN

COMMISSIONER

9
10 COMMISSIONER

COMMISSIONER

COMMISSIONER

11
12 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
13 Director of the Arizona Corporation Commission, have
14 hereunto set my hand and caused the official seal of the
15 Commission to be affixed at the Capitol, in the City of Phoenix,
16 this _____ day of _____, 2008.

17 BRIAN C. McNEIL
EXECUTIVE DIRECTOR

18 DISSENT _____
19

20 DISSENT _____
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1 SERVICE LIST FOR: SHEPARD WATER COMPANY, INC.
2 DOCKET NOS.: W-01537A-07-0264 and W-01537A-07-0265

3
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